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WISCONSIN LEGISLATIVE COUNCIL STAFF

INFORMATION MEMORANDUM 77-13

Room 147 North
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Madison, Wisconsin 53702

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COMPARISON OF ESTATE TAXATION AND INHERITANCE TAXATION

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This Information Memorandum was prepared for use by the Special Committee on Inheritance Taxation which was created by Chapter 222, Laws of 1975. It sets forth (1) the differences in the concepts of an estate tax and an inheritance tax; (2) the use and yield of the estate tax approach and the inheritance tax method by the states; (3) the chronology of death tax legislation in Wisconsin and at the federal level; and (4) the arguments for preferring the estate tax or the inheritance tax.

The Estate Tax and Inheritance Tax Concepts

Conceptually, an estate tax is a tax imposed on the right to transmit property from a decedent's estate to living distributees (sometimes called donees, beneficiaries, heirs or legatees). It is measured solely by the value of the property in the estate. An estate tax is not a property tax but rather a capital transfer tax, which is triggered by the death of a property owner.

An inheritance tax is also a death tax but it is levied upon the right to receive property upon the death of another. It is a succession tax which is measured in part by the value of the property received by an individual and in part by the distributee's marital or familial relationship to the decedent. In general, the more remote the relationship, the higher the tax rate and the lower the exemptions available to the distributee. The inheritance tax, like the estate tax, is not a property tax but rather a capital transfer tax imposed at the death of the former property owner.

Both the estate tax and the inheritance tax are considered transfers taxes and thus are exempted from the federal constitutional doctrine of intergovernmental immunities.* Therefore, the federal

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* The doctrine developed in the 19th Century to protect federal and state governments from the adverse effects which the exercise of their taxing powers might have on each other's powers. Today, a principal part of the doctrine is the exemption of federal bonds from state income or property taxes and the exemption of state or municipal bonds from federal income taxes.

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government may tax the transfer of state securities and the state government may tax the transfer of federal bonds. Jurisdiction to levy either an estate tax or an inheritance tax depends upon the location of the property or the domicile of the decedent rather than the domicile of the distributee.

A third form of death tax used by some states is the federal credit allowed under the federal estate tax laws for death taxes paid to a state. The credit varies with the size of the estate included in the determination of the federal estate tax. Most states levy this tax as a supplement to their basic inheritance or estate tax in order to benefit by the federal provision at no cost to their taxpayers. It is called an "estate tax" in states using the inheritance tax method and an "additional estate tax" in states relying upon the estate tax approach. Some states use this form of death tax as the only tax upon a decedent's estate.

State Death Taxes

Most states levy an inheritance tax. Only Nevada does not impose an estate tax or an inheritance tax. Only Rhode Island uses both the estate tax and the inheritance tax. Eleven states use the estate tax approach, 33 states rely upon the inheritance tax method and six states use only the federal credit for a state death tax. All of the states impose an additional estate tax to take maximum advantage of the federal credit for state death taxes except Nevada, North Dakota, South Dakota and West Virginia and except, of course, the six states which rely solely upon the federal credit tax method.

The six states which only use the federal credit for state death taxes include:

Alabama	Florida
Alaska	Georgia
Arkansas	New Mexico

The eleven states which impose an estate tax are:

Arizona	Oklahoma
Massachusetts	Rhode Island
Mississippi	South Carolina
New York	Utah
North Dakota	Vermont
Ohio	

The 33 states which levy an inheritance tax include:

California	Indiana	Michigan
Colorado	Iowa	Minnesota
Connecticut	Kansas	Missouri
Delaware	Kentucky	Montana
Hawaii	Louisiana	Nebraska
Idaho	Maine	New Hampshire
Illinois	Maryland	New Jersey

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North Carolina	South Dakota	Virginia
Oregon	Tennessee	West Virginia
Pennsylvania	Texas	Wisconsin
Rhode Island	Washington	Wyoming

In 1975, the 50 states raised approximately $134.6 billion in general revenue of which death and gift taxes accounted for $1.4 billion, or about 1% of the general revenues raised by the states. Inheritance, estate and gift taxes in Wisconsin in 1975 accounted for $47 million, or about 1.4% of the $3.3 billion in general revenue received by Wisconsin from its taxpayers. Table A ranks the states from the lowest to the highest per capita dollar amounts of death and gift taxes collected by the states in 1975. (Table A is found in page 6.)

Chronology of the Wisconsin Death Tax

1899 The first statewide inheritance tax on bequests from estates of $10,000 or more was enacted.

1902 Black v. State (1902), 113 Wis. 205, held the 1899 inheritance tax law unconstitutional because it conferred special privileges on certain recipients of bequests which is in violation of the Equal Protection Clause of the U.S. Constitution.

1903 An inheritance tax with graduated rates was enacted for all estates.

1906 Nunnemacher v. State (1906), 129 Wis. 190, upheld the constitutionality of the 1903 tax law.

1931 An estate tax to reap the maximum benefit of the federal credit for state death taxes was enacted.

1971 Significant changes in the procedural and substantive provisions of Wisconsin inheritance tax laws were enacted.

1973 Interspousal transfer tax rates were reduced.

1976 The "federal" financial contribution criterion for including joint tenancy property in the estate of the decedent was modified to the extent that a joint tenancy exemption of one-half the value of the property is available for completed transfers which are subject to gift taxes.

Chronology of Federal Death Taxes

1797 Congress enacted a stamp tax on "legacies and shares" in intestate estates. Actually, no tax was collected because it was postponed until it was repealed in 1802.

1862 An inheritance tax on personal property and later on real property was enacted. It was repealed in 1970 but held constitutional in Scholey v. Rew (1874), 23 Wall 331.

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1894 The Income Tax Act of 1894 required that property acquired by gift or inheritance be taxed as ordinary income. It was held unconstitutional in Pollock v. Farmers' Loan & Trust Co. (1895), 157 U.S. 429, rehearing 158 U.S. 601.

1898 Congress enacted a graduated inheritance tax which was repealed in 1902. It was held constitutional in Knowlton v. Moore (1900), 178 U.S. 41.

1916 An estate tax was enacted and later held constitutional in New York Trust Co. v. Eisner (1921), 256 U.S. 345.

1924 Credit against the federal estate tax for the state death tax was made available for up to 25% of the federal tax. The credit was increased by Congress in 1926 to 80% of the federal tax.

1932 An effective ceiling on the federal credit for state death taxes was created by establishing an additional estate tax against which there was no credit for state death taxes.

1943 Marital deduction was introduced into the estate tax determination.

1954 Congress enacted a codification and revision of the Internal Revenue Code.

1976 Substantial modifications of the estate and gift tax laws were enacted (1) to unify the gift and estate tax rates and deductions; (2) to replace the consideration furnished (financial contribution) test with a fractional share rule for completed joint tenancy transfers; (3) to introduce current use valuation of certain realty; (4) to provide a carryover basis for inherited property; and (5) to subject generation-skipping trusts to taxation.

Arguments Asserted in Favor of the Estate Tax Method

1. The administration of the tax is simplified. For example, it is not necessary to provide for subsequent collection or refund after contingent remainders are ascertained. (Note, however, that the valuation of charitable remainders must be computed for deduction purposes.)

2. The determination of the tax is simplified because it is not necessary to interpret wills and trusts in order to ascertain the rights of distributees.

3. The estate tax raises more revenue than the inheritance tax with the same rates. This makes it more effective in breaking up wealth concentrations than an inheritance tax would be.

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4. The absence of preferred rates and exemptions for family members (other than a spouse) reduces the tax incentives for wealth owners to perpetuate their capital within the family from generation to generation.

5. The tax determination and collection is not dependent upon local court constructions of wills or local probate office determinations.

6. The estate tax allows a decedent the maximum opportunity to transmit his or her property as he or she wishes without tax burden distortions.

Arguments Asserted in Favor of the Inheritance Tax Method

1. The inheritance tax increases the Legislature's capacity and flexibility to determine the incidence of the capital transfer tax at death. (Note, however, the federal estate tax does provide a marital deduction and an orphan's exclusion.)

2. Inheritance taxation automatically falls on the distributees in proportion to their distributive shares unless the statutes provide otherwise. (Wisconsin makes both the estate and the distributees liable, but the liability of a distributee is limited to the share of the estate received by the person.)

3. Separate rate structures for each type of distributee encourage but do not force wealth deconcentration by minimizing taxes where an estate is divided among many beneficiaries.

4. It is fairer to base a tax on the amount of property individual living beneficiaries receive than on the total amount of wealth amassed by a decedent before death.

5. The social desirability of encouraging a decedent to continue the support of his or her own dependents is facilitated by the preferred rates and exemptions available for close family members.

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TABLE A

DEATH AND GIFT TAXES: 1975
(PER CAPITA DOLLAR AMOUNTS)

Rank		Amount	Rank		Amount
1	Nevada	$ 0	26	North Carolina	$ 5.09
2	Alaska	19	27	Kentucky	5.25
3	Arkansas	77	28	Vermont	6.36
4	Georgia	1.00	29	South Dakota	6.59
5	Nebraska	1.03	30	Tennessee	6.65
6	Alabama	1.09	31	Illinois	6.67
7	New Mexico	1.37	32	Indiana	6.86
8	Arizona	1.67	33	Montana	7.21
9	Mississippi	2.02	34	New Hampshire	7.30
10	South Carolina	2.26	35	Colorado	7.37
11	Ohio	2.30	36	Maine	8.03
12	North Dakota	2.64	37	New York	8.07
13	Louisiana	3.08	38	Rhode island	8.55
14	Utah	3.14	39	Oklahoma	9.07
15	Maryland	3.56	40	Oregon	9.60
16	Missouri	3.79	41	Washington	10.05
17	Virginia	3.88	42	Wisconsin	10.23
18	Texas	3.91	43	Iowa	10.26
19	Michigan	3.94	44	Massachusetts	10.50
20	Hawaii	4.02	45	Pennsylvania	10.68
21	West Virginia	4.05	46	Minnesota	10.75
22	Florida	4.10	47	New Jersey	11.37
23	Wyoming	4.21	48	California	11.31
24	Idaho	4.43	49	Delaware	13.88
25	Kansas	5.07	50	Connecticut	14.95

National Per Capita
Average Death and Gift Tax
(Per Year) - - - - - - - - - - - $6.68

Median State Average
(Per Year) - - - - - - - - - - - $5.09

SOURCE: United States Department of Commerce, Bureau of the Census, State Government Finances in 1975, Government Finances/GF 75, No. 3, August 1976.

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